

Medicare and Medicaid program changes and payment reductions made it more difficult for hospitals to cover expenses.

Regulatory Changes

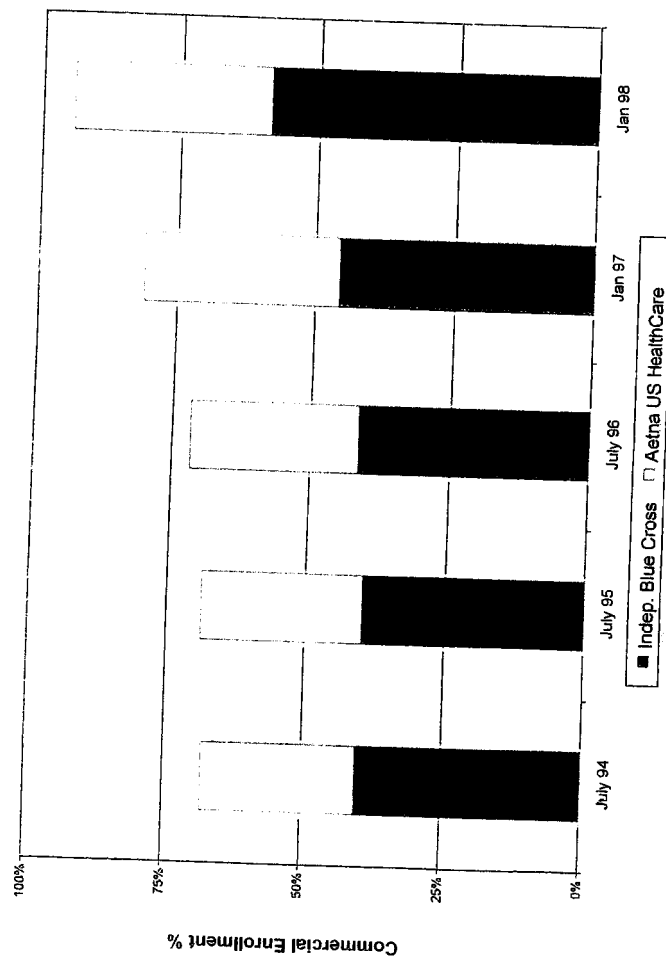
- Medicare
 - ➔ Balanced Budget Act (BBA) of 1997 implemented a 5-year reduction in hospital Medicare payment beginning in FY1998
 - ➔ Increasingly more people were enrolled in Medicare HMOs that paid hospitals less
- Medicaid
 - ➔ The 1996 Welfare Reform / Act 35 of PA imposed new restrictions on Medicaid program eligibility and reduced Medicaid volume
 - ➔ The state of PA implemented HealthChoices, a mandatory Medicaid managed care program, in FY1997

Source: AHERF, BDC Advisors, LLC analysis

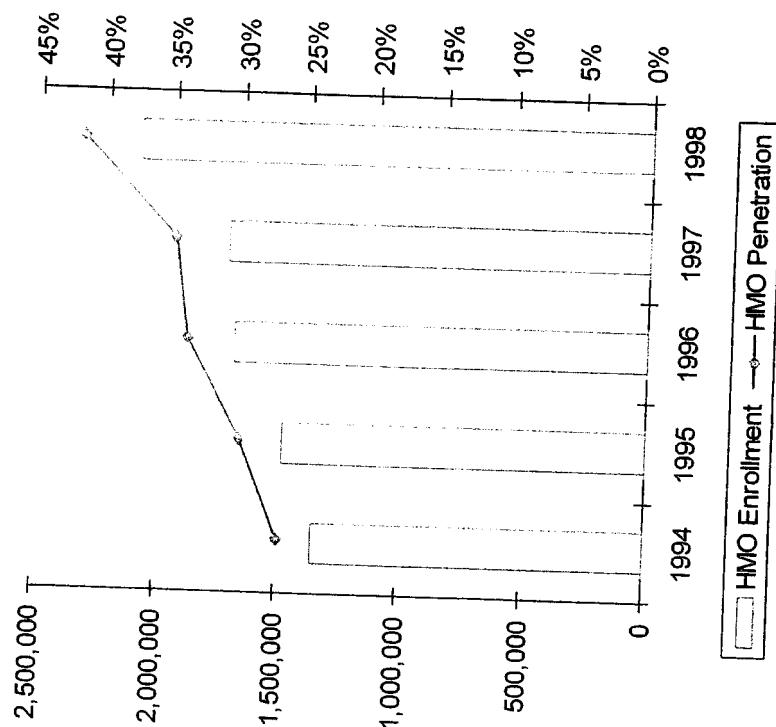
Market Environment . . . Health Plans

The Philadelphia market was dominated by two health plans and increasingly more people were enrolled in HMOs.

Greater Philadelphia Health Plan Market¹



Managed Care Growth²



Notes: (1) Greater Philadelphia defined as Philadelphia, Bucks, Chester, Delaware, and Montgomery Counties; Commercial (including HMO) population defined as total population less Medicare eligibles and less Medicaid recipients
 (2) Total commercial (including HMO and PPO), Medicare and Medicaid HMO enrollment

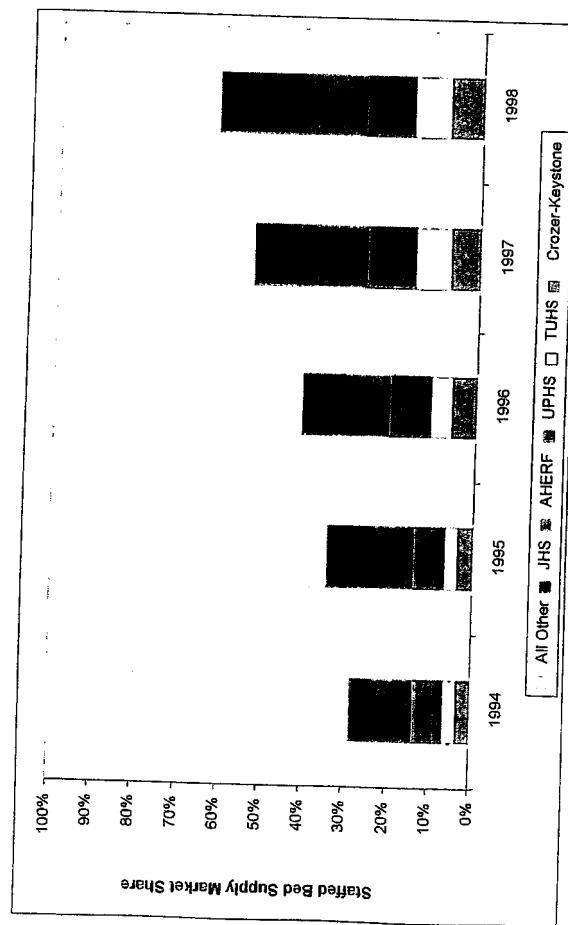
Source: InterStudy Industry Reports, 1994-1999; PA State Data Center, 1995-1999; BDC Advisors, LLC analysis

BDC Advisors, LLC

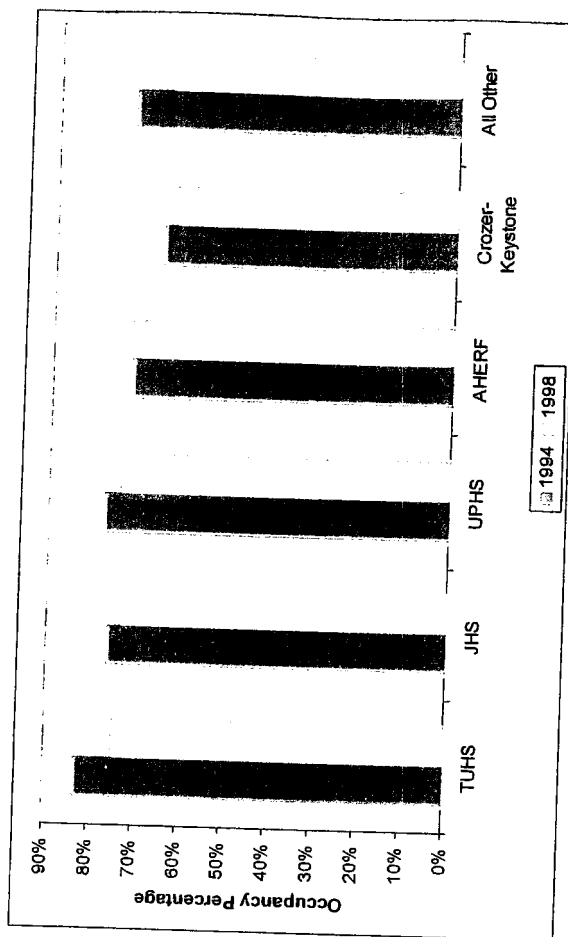
To balance the power among hospitals against two major health plans and respond to managed care, hospitals actively consolidated ownership but did not consolidate bed supply sufficiently to increase occupancy.

Hospital System Arms Race in Greater Philadelphia (1994 – 1998)

Staffed Bed Supply Market Share



Hospital Occupancy



Note:

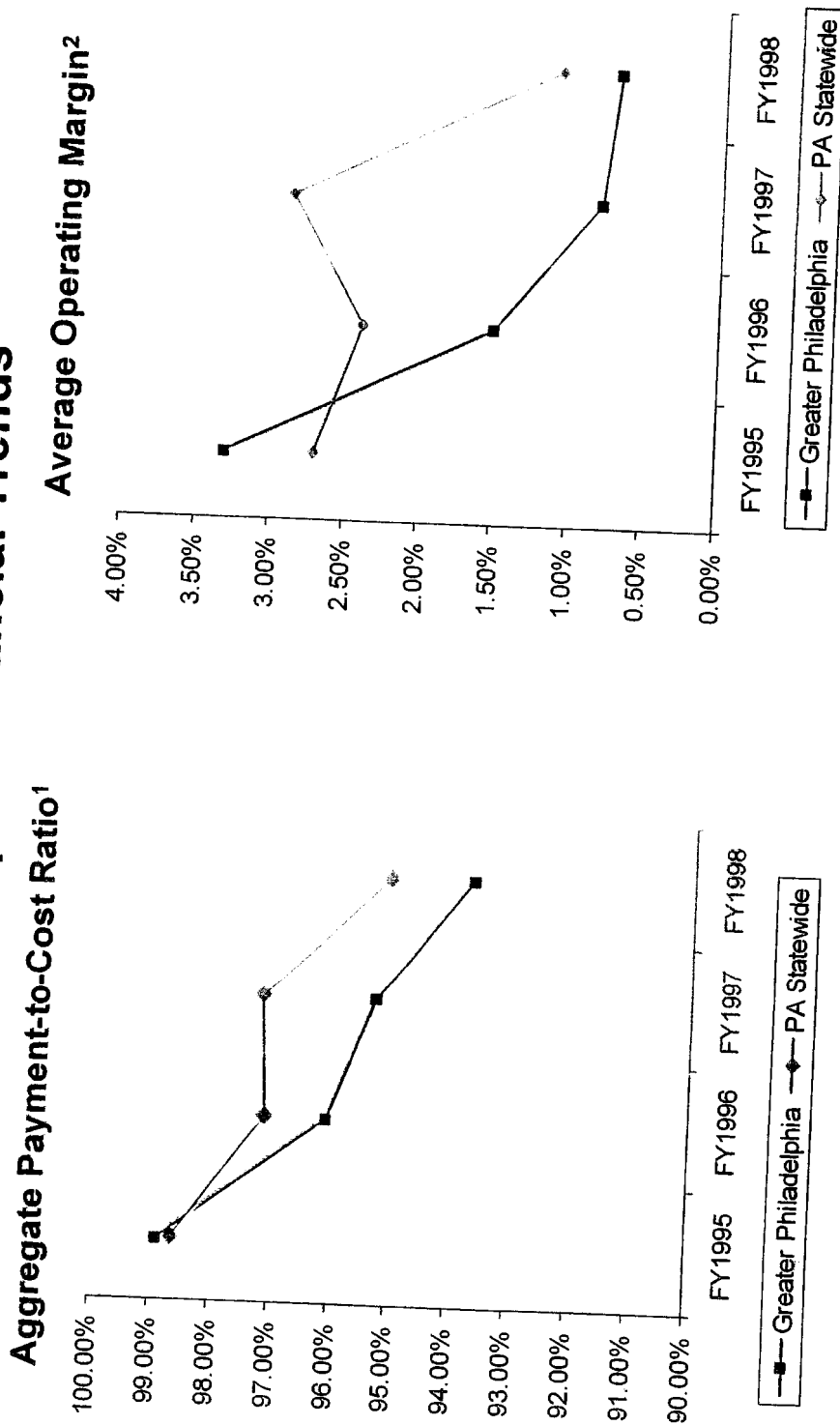
- (1) Greater Philadelphia defined as Philadelphia County and the border PA counties of Bucks, Chester, Delaware, and Montgomery
- (2) Excludes all health system hospitals not located within Greater Philadelphia
- (3) Excludes all facilities dedicated to nursing home, psych, rehab, and other long-term care
- (4) Staffed bed supply is dynamic and based upon hospital affiliation by year (e.g. Taylor Hospital affiliates with UPHS 1994 – 1996 and then affiliates with Crozer-Keystone as of 1997)

Source: PA Dept of Health, Division of Health Statistics (1994 – 1998); Gartner Group; BDC Advisors, LLC analysis

Market Environment . . . Impact

As hospital payments continued to decline, financial performance deteriorated among hospitals in Philadelphia.

PA Hospital Financial Trends



Notes:

(1) Payment-to-cost ratio = total net patient revenue / total operating expense

(2) Philadelphia operating margins derived based on published PA statewide average operating margin and the relationship between PA and Philadelphia NPR-to-total operation expenses relationship

Source: PA Health Care Cost Containment Council 1998 Hospital Financial Analysis Report; BDC Advisors, LLC analysis

BDC Advisors, LLC

Regulatory Events